

UNIVERSITY OF CALIFORNIA AT BERKELEY

Department of Economics

Berkeley, California 94720-3880

CENTER FOR INTERNATIONAL AND DEVELOPMENT  
ECONOMICS RESEARCH  
Working Paper No. C96-065

**Efficiency, Equity and Poverty Alleviation:  
Policy Issues in Less Developed Countries**

Pranab Bardhan

University of California, Berkeley

March 1996

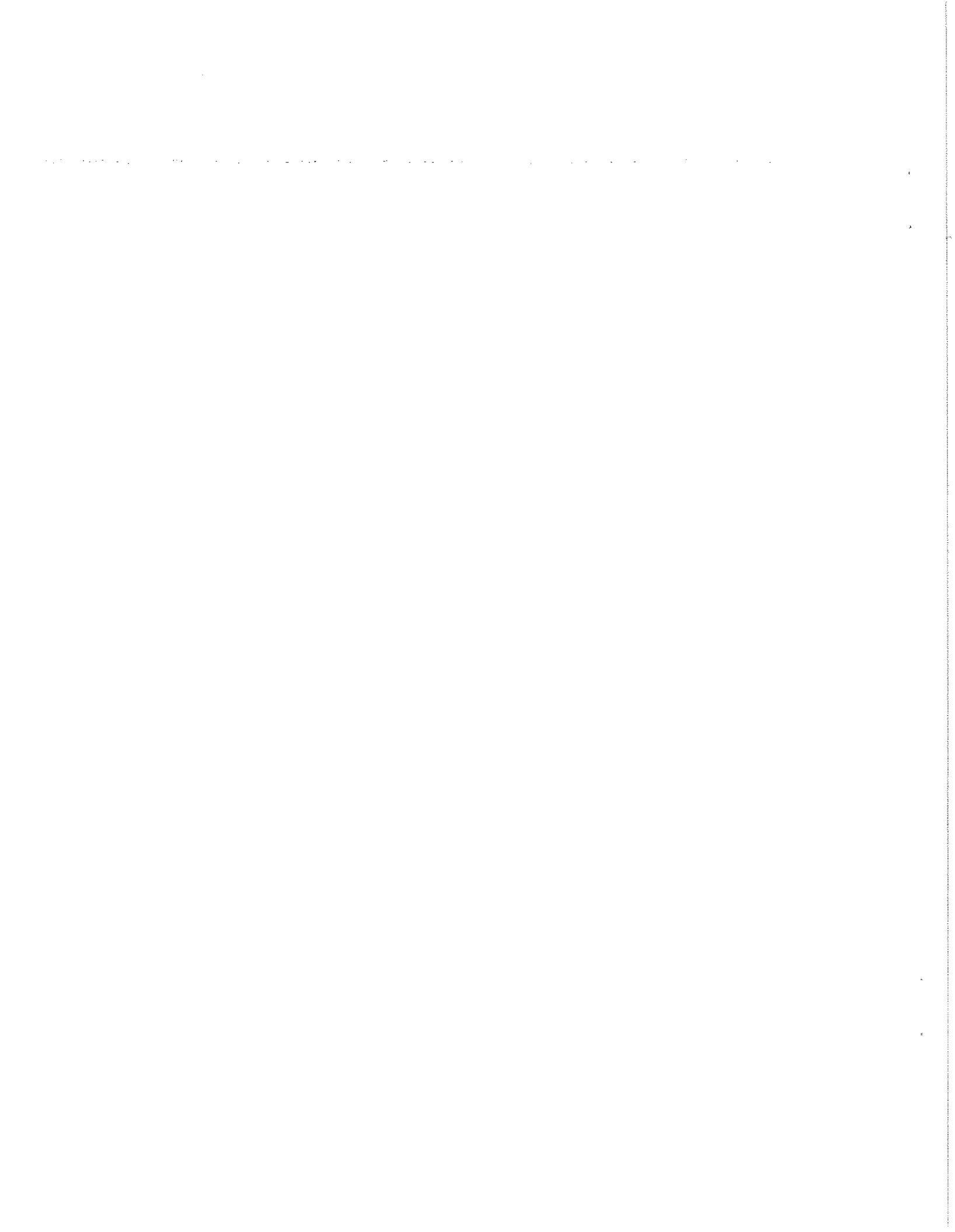
Key words: redistribution, targeting, disadvantaged groups  
JEL Classification: I30, O15

Abstract

In this paper we start by noting that policies that help growth by improving allocational efficiency may also help the poor. We then go on to consider cases where in view of serious agency costs and coordination problems (particularly involving processes in credit and insurance markets) there may be a great deal of scope for trying redistributive projects which at the same time enhance productive efficiency, contrary to the message of efficiency-equity trade-off central to mainstream policy economics. In this context we discuss the efficiency effects of asset distribution programs like land reform. We then examine the merits and costs of targeting transfers aimed at improving their cost-effectiveness, including issues of self-selection by the poor and of targeting disadvantaged groups and backward areas. Finally, we discuss governance structures and focus on the role of self-governing institutions at the local level in improving efficiency and equity in poverty alleviation.

---

Forthcoming in the *Economic Journal*, September 1996.



Efficiency, Equity and Poverty Alleviation:  
Policy Issues in Less Developed Countries

by

Pranab Bardhan

University of California at Berkeley

I

In the poor countries of sub-Saharan Africa and South Asia (the areas where mass poverty in the world is geographically concentrated) poverty by any reasonable measure is so pervasive that policies of poverty alleviation encompass practically the whole range of development policies. Most policies that significantly affect the national economy have also substantial implications for the poor. The efficiency-equity trade-off which is at the heart of much of mainstream policy economics is thus central to the policy debates on poverty. If redistribution in favour of the poor comes at a significant cost in terms of misallocated resources and aggregate income losses, it can be a much more serious issue in economic policy in poor countries (both because the poor form a much larger proportion of the population and because one can afford such losses less at low levels of income) than even the controversies that rage around the efficiency impact of the 'welfare' budget in rich countries.

This issue is reflected in a running policy debate in poverty alleviation over the last twenty-five years, on the relative importance of market-driven growth as it trickles down to the poor as opposed to a programme of massive and direct intervention to help the poor. In this paper we shall start with a discussion of some of the issues in this debate, and proceed to situations where

the efficiency-equity trade-off may be false or exaggerated (particularly when agency costs and coordination problems are taken into account), which in turn may have interesting policy implications in terms of possible efficiency-enhancing redistributive projects. In this context we shall also discuss the relative efficiency effects of asset distribution policies (like land reform) as opposed to tax-transfer policies that take the form of subsidies. Within transfer policies in general we shall discuss the merits and costs of efficient targeting, including issues of self-selection by the poor and of targeting underprivileged groups and backward areas. Finally, we discuss governance structures and focus on the role of local self-governing institutions in improving efficiency and equity in poverty alleviation.

## II

In the recent past and, even currently, the governments in many poor countries have heavily interfered in the market in the name of helping the poor. They have used high tariffs, quantitative trade restrictions and overvalued exchange rates, subsidised credit and underpriced energy, water, and other publicly provided inputs to help domestic producers. They have used price control and trade restrictions on agricultural commodities to keep food prices low for the urban poor. They have used industrial and investment licences to keep larger producers at bay and help small-scale, sometimes inefficient, producers. They have imposed high marginal tax rates and public sector dominance in production with the objective of reducing concentration of income and wealth. The experience of the last four decades has shown that

many of these policies have been counterproductive from the point of view of both efficiency and equity. Economic growth has often been stunted, while the conditions of inequality have not significantly improved, and in some cases even worsened.

In the more recent literature on poverty there is a better appreciation of the fact that market-driven economic growth need not be inconsistent with poverty alleviation. In many countries, in East and Southeast Asia in particular, fast outward-oriented growth has been associated with substantial reductions in mass poverty. In general, the most important way for economic growth to help the poor is by expanding their opportunities for productive and remunerative employment (including self-employment on farms and in artisan shops). There is now some measure of agreement that policies that contribute to growth by improving the allocative efficiency of resource use (say, by reducing distortions in relative prices, exchange rates, and trade policies) may help the poor. This is particularly so if the traded goods sector is more labour-intensive than the non-traded goods sector and if exports are more labour-intensive than import-substitutes (assuming, of course, that the workers have some basic education and skills). Underpricing of scarce inputs -- such as capital, energy, and environmental resources -- often leads to the adoption of capital-intensive and environment-damaging projects that have adverse distributional consequences. Movements of terms of trade in favour of agricultural commodities and removal of restrictions on their trade may help the poor if the sector consists of a large number of small farmers who market a significant part of their output and if the wages of landless labourers do not lag far behind the price rises.

## III

Of course, some types of growth do not help the poor. In situations of severe capital market imperfections the escape routes from poverty for the unskilled and the assetless may remain blocked, while growth improves the prospects for capital-intensive or skill-intensive projects. The centripetal forces of growth with increasing returns may drain resources away from backward regions reinforcing regional polarisation, as economic geographers have repeatedly shown. Large projects of industrialisation and commercialisation may uproot and disenfranchise sections of the poor from their traditional habitats and their access to common property resources. In most of these cases the gainers can afford to compensate the losers, but in the actual political process they seldom do.

On the other hand, there are many projects which by relieving the severe constraints faced by the poor and improving their conditions can help economic growth in the process. This runs somewhat contrary to the preoccupation of mainstream economics with the equity-efficiency tradeoff, with its emphasis on the various costs of redistribution in terms of reduced economic incentives and performance. (In a widely cited passage Okun (1975), for example, described redistribution to be like carrying money from the rich to the poor in a 'leaky bucket'). There are, however, many situations, particularly in poor countries, when this famous trade-off may be false or at least exaggerated. One such situation, which non-economists are quick to point out, is when rampant poverty breeds crime (and other 'extra-legal appropriative activities', to use Grossman's (1992) term) and political instability, which can have damaging consequences for investment and macro-

economic efficiency in general. Another case relates to an old idea in development economics, about the link between nutritional intake and work efficiency in situations of extreme poverty. An important corollary of this original brand of efficiency wage theory is that a more egalitarian distribution of land, for example, by reducing the malnourishment (and thus improving the employability) of the currently unemployed, may lead to a rise in the aggregate output in the economy, as shown by Dasgupta and Ray (1986).

A third type of situation, actually quite pervasive, arises when redistributive policies help economic growth by correcting market failures that particularly affect the poor. The imperfections of the credit and insurance markets are especially important here. These imperfections and the usually costly private adjustments to them can cause poverty traps in which the poor get caught.<sup>1</sup> Expanding the opportunities for credit, for example, can help the poor to invest in education as a way of climbing out of poverty. It can also make small farmers and artisans more economically viable by allowing them to enlarge their scale of production, to take up more high-return high-risk projects or occupational choices, and in general to avoid constrained myopic policies. In this way redistributive policies can increase a society's aggregate potential for productive investment, innovation and human resource development.

Some of these activities (like better education and health of the poor) have also important positive externalities for the rich. Positive externalities arise also in the context of gender-specific poverty alleviation policies. Better education for women is often associated with better education, nutrition, and health of children (particularly daughters); better opportunities for outside

---

<sup>1</sup> For theoretical models that expand on this theme, see Banerjee and Newman (1993) and Galor and Zeira (1993).

work for young women can lead to socially more beneficial fertility behaviour (through, say, raising the age at marriage). Such externalities make gender equity and efficiency go together. Then there are important dynamic externalities which arise from community or neighbourhood-specific characteristics; these may refer to physical infrastructure (like roads, communications, irrigation and power systems) improving the productivity of private investment, or adult human capital endowments (influencing the educational investment decisions of the young) in the neighbourhood or, somewhat more intangibly, to what is often described as 'social capital' in the form of social networks, peer group effects, role models, connections in the job market, etc. (the lack of which has been emphasised in the studies of poverty traps in the inner-city ghettos in the United States<sup>2</sup>, but similar effects may be observed in poor countries for backward areas or socially disadvantaged groups, or even the rural sector in general from which there is a continuous 'brain drain' to the metropolitan cities). If these externalities are important, anti-poverty programmes have to go beyond policies addressed to individuals and households per se, and policies aimed at poor areas and groups as a whole may be fruitful in terms of both equity and efficiency. We shall come back in section V to discuss the issue of preferential job and education policies for some disadvantaged groups in this context.

Going back to the case of credit and insurance market failures (which originate from problems of moral hazard, adverse selection and enforcement), they point to a general principle now recognised in the literature on imperfect information and agency costs: when information is incomplete and competing claims are seldom resolved in costlessly enforceable contracts the usual separability of equity and efficiency of mainstream

---

<sup>2</sup> See, for example, Crane (1991).



economics breaks down. Under the circumstances the terms and conditions of contracts in various transactions that directly affect the efficiency of resource allocation crucially depend on who owns what and who is empowered to make which decisions. In general redistributions of property rights, if they align control of non-contractible actions more closely with residual claims over the outcomes of these actions (for example, a tenancy reform in agriculture that assigns residual claimancy rights to the tenant whose productive efforts are difficult to monitor for the landlord), will improve efficiency.

This general idea has also implications for economic governance structures.<sup>3</sup> Government failures in policy design and implementation (including in poverty alleviation) are partly caused by information and transaction costs. A realignment of the governance structure in favour of decentralisation or devolution of power to a local level can create important incentives by placing decision-making in the hands of those who have localised information that outsiders (like the central bureaucrats) lack. In situations when the state bureaucracy is thus informationally hamstrung while similar information problems render individual market contracts incomplete or unenforceable (as in the case of credit and insurance mentioned above), a local community organisation, if it has stable membership and well-developed mechanisms for transmitting private information and norms among the members, has the potential to provide more efficient coordination than either the state or the market. We shall come back to discuss this in the context of poverty alleviation in section VI.

---

<sup>3</sup> For a comparative evaluation of markets, states and communities in the context of coordination failures caused by agency problems, see Bowles and Gintis (1995).

## IV

Since credit market failure is widely regarded as one of the crucial factors behind the persistence of poverty, intervention in this market has been one of the major planks of anti-poverty policy. Over the last three decades there have been many cases in poor countries of the government trying to provide subsidised credit to the poor. The results have been mixed (as, for example, in the case of one of the largest credit programmes for asset-building by the rural poor in the world, the Integrated Rural Development Programme in India). Wealthier borrowers have often appropriated the credit subsidies meant for the poor. In general underpricing of credit has led to inefficient use of capital. Credit administered through government or semi-government agencies weakens incentives to invest wisely or to repay promptly: building political connections to get debt relief and rent-seeking sometimes become more important than responsible investment behaviour. Political patronage in the matter of loan disbursement or moratorium has rendered the whole financial system quite shaky in some countries. Even ignoring the problem of political clientelism, the fundamental dilemma of the credit market is that outside agencies (including government banks) do not have enough local information about the borrower and monitoring is costly, and so they insist on collaterals which ration out many of the poor; on the other hand, the local lenders who have more personalised information about the borrower often use this informational entry barrier to the credit market to charge high interest rates.

In localised pockets in different parts of the world today there are some success stories in resolving this dilemma through the use of borrower groups

as mechanisms of overcoming information and enforcement problems -- as in the widely cited Grameen Bank experiment in Bangladesh, where credit for groups of poor women is organised along lines of joint liability. Such group lending schemes seem to work best in small relatively closed communities where peer monitoring and social sanctions against local deviants are easier to organise and sustain over repeated transactions, and where the group members have largely uncorrelated but similar levels of income. In addition when loan contracts are linked with explicit or implicit insurance against adverse shocks to income, borrowers default much less.

Another general point to note is that in a world of private and asymmetric information a credit subsidy to a poor family may be dominated in terms of efficiency by a lump-sum grant or asset transfer to the same family. Hoff and Lyon(1995) have a theoretical model to illustrate this in the context of financing investment in education (the probability of successfully completing the education programme being private information to the investor). The intuition is that the transfer by adding to the borrower's collateralisable wealth makes him or her bear more of the consequences of his or her 'hidden' action ( i.e. unobserved by the lender) and thus improves the link between performance and rewards. But a subsidy to borrowing aggravates the inefficiency caused by the fact ( a source of negative externality) that individual borrowers do not take into account the cost borne by others (in the form of a higher interest rate charged) when they default, as the interest rate has to reflect the average risk of individual borrowers who are observationally equivalent to the lender. In the context of asymmetric information which creates a potential for negative externalities that may result in shutting low-wealth individuals out of a market, asset redistributive policy is thus not merely more equitable, but it may also enhance efficiency by

internalising those externalities through an increase in the collateral of the poor borrower.

Among asset-redistributive poverty alleviation measures one of the most popular (though resisted tenaciously and sometimes violently by the vested interests) is that of land reform. In traditional agriculture (outside the plantation economy), where the use of lumpy inputs such as farm machinery is limited, the economies of scale in production are not substantial, and the small farm with a differential advantage in labour cost is often more productive than the large, as empirical evidence from many poor countries suggests. Of course, the larger farmer is likely to have better access to production credit (particularly significant as purchased inputs become more important in modern agriculture), to information and marketing networks, and to the capacity to diffuse and insure against risks. If these services can be made available to the small farmer (with proper attention paid to possible adverse incentive effects like those following from problems of moral hazard in insurance against risks), land redistribution may boost productivity and reduce poverty. But to be realistic one should recognise that in some densely populated poor countries (like Bangladesh) the "surplus" land for redistribution (with any reasonable ceiling on large farms) is likely to be far short of what is needed to make a big dent in poverty. The redistribution of land from large to small farmers may also reduce the demand for hired labour (while correcting the underutilisation of family labour on small farms), and depress the wage rates for landless labourers, particularly if they get no land in the land reform.

Tenancy reform by rearranging property rights in favour of the actual cultivator of the land can improve production incentives. Security of tenure, if properly implemented, provides incentives for long-term improvements on

the land. It should, however, be noted that without adequate enforcement of tenurial security and without effective ceilings on farm size, restrictions on tenancy have led in many areas to the eviction of tenants or the conversion of erstwhile tenants into wage labourers. Besides, as Hayami and Otsuka (1993) point out with examples from the irrigated rice sector in the Philippines, such restrictions may close the possibility for agricultural labourers at the bottom to climb the tenancy ladder.

One beneficial by-product of land reform, underemphasised in the usual economic analysis, is to change the local political structure in the village. Redistributive land reform gives more "voice" to the poor and induces them to get involved in local self-governing institutions and in common management of local public goods. Furthermore, local markets (say, for farm products or credit or water) function more efficiently when the levelling effects of land reform improve competition and make it more difficult for the rural oligarchy to corner markets.

Given the strength of opposition of vested interests many regard the political prospects for land reform in most developing countries as bleak, and therefore drop it altogether from the agenda of poverty alleviation. This is not always wise. Some aspects of land reform (like extension of tenurial security) may be less difficult to implement than others (like land ceilings). Besides, in the dynamics of political processes and shifting coalitions, the range of feasibility often changes; and options kept open contribute to the political debate and may influence the political process. Some policy advisers (from international lending agencies) who rule out land reform as politically infeasible are at the same time enthusiastic supporters of other poverty alleviation policies that may be no less politically difficult; an example is the strict targeting of food subsidies and thus cutting the substantial present

subsidies to the vocal urban middle classes. In the game of political coalition formation a radical policy sometimes becomes implementable if it helps cement strategic alliances, say between sections of the urban upper classes (including white-collar workers) and the rural poor.

## V

One of the most widely discussed efficiency issues in connection with various transfer programmes and maintenance of a safety net for poor families relates to that of targeting and cost-effectiveness. With structural adjustment programmes necessitating large cuts in budgetary subsidies in many countries, targeting transfers to vulnerable groups has become even more important, since the leakages from transfer programmes to nontarget groups are often considerable while failure to reach all in the target group is much too common. But the administrative costs of targeting can be considerable, particularly when reliable and cheaply administered means tests are infeasible in many contexts of less developed countries. Behavioural responses (particularly in the form of reduced labour supply and displaced private transfers) may create extra costs to targeted interventions, as some of the case studies in van de Walle and Nead (1995) testify. In addition, and potentially fatally for the anti-poverty programme, a transition from a universal to a narrowly targeted programme may seriously erode its political support base. As Gelbach and Pritchett (1995) show, a classical social choice theory model, in which agents vote simultaneously over the level of taxation and the degree of targeting, will have no equilibria with positive levels of targeted transfers and a voting equilibrium often will exist with no targeting

(but non-zero taxation and redistribution). Then they show that in a game in which the policymaker chooses the degree of targeting while voters choose the level of taxation, the redistributive efficiency gains from targeting may well fail to outweigh the resulting reduction in funds available for redistribution. They cite empirical examples from food subsidy programmes in Sri Lanka and Colombia to indicate that episodes of increased targeting have been followed by reductions in overall benefits.

Going back to the administrative costs of targeting, there are obvious arguments in favour of transfer programmes based largely on self-targeting. For example, the public distribution of subsidised food could cover only coarse grains or other "inferior" goods that the non-poor usually do not consume. Similarly, public works programmes involving heavy manual work are not attractive to the non-poor. (In both cases, however, bogus master rolls still divert some funds to non-poor middlemen). Subsidising coarse grains through food stamps is generally preferable to public procurement and distribution (as in India), since the government does not have to be involved in the purchase, transport, and storage of the commodities (a significant part of the large budgetary food subsidy in India). To counter the effect of a rise in food prices, as happened with the food stamp programme in Sri Lanka, governments should consider indexing the value of the stamps to the price of coarse grains or other such goods bought only by the poor. In the case of public works programmes, while some costs in terms of foregone alternative earnings have to be taken into account, their major role in very poor rural areas is to provide a fall-back option for agricultural labourers in lean seasons and bad crop years and to increase their usually low bargaining power in the labour market. Of course, such works programmes cannot help those in the needy population who are unemployable, on account of physical and other

disabilities, who will need disability-specific in-kind transfers (such as medical treatment or old-age pension or nutrition for pregnant and nursing women).

Similar to the case of coarse grains and works programmes, distribution of rudimentary social services like primary education or basic health care is usually somewhat pro-poor, as some of the existing studies of the incidence of the benefits of public spending on social services suggest. This is presumably because the rich often turn to the private market for primary education and basic health care, and because the poor have in general larger families or more dependents. The distribution of the benefits of public spending for higher education and expensive medical care in urban hospitals is likely to be much more regressive. So the existing practice in many countries of charging low prices across the board for different social services regardless of cost, accompanied by quantity rationing or quality reductions when budgets are tight, has not served the poor either in the quantity or quality of services. High-cost services consumed by the rich are often subsidised more than low-cost services, so selective increases in user fees (with exemptions for the very poor or for some basic services) can serve both efficiency and equity.<sup>4</sup>

Let us now turn to the issue of group or area-specific targeting in poverty alleviation. There are some groups and areas which are historically handicapped and their initial conditions lock them into poverty unless special remedial attempts are made to change the situation. Take the case of women. Women in many parts of the world face special social and economic

---

<sup>4</sup> There is a separate debate in the literature on the effects of schooling about whether expanding access to schools should be given priority over improving their quality, when funds are scarce. See, for example, the debate on this matter between Eric Hanushek and Michael Kremer in the *World Bank Research Observer*, vol.10, August,1995; both, however, agree that improving school quality will increase attendance, that investments in textbooks and radio education are more important than in reducing class size, and that new organisational forms and performance incentives may provide better and less expensive education.



constraints in acquiring and using human capital. In Africa and in West and South Asia more than 70 percent of women 25 years old or older are illiterate. Even for girls in the 6-11 age group, the proportion out of school is above 25 percent in sub-Saharan Africa and above 15 percent in South Asia (these rates do not include the high absenteeism and drop-out rates). One of the usually overlooked constraints is the lack of childcare facilities which often forces young daughters of poor working women to skip school to take care of their siblings, perpetuating the cycle of low education and low-paid jobs for women from one generation to the next. The legal and cultural barriers to entering the labour market are often formidable for women, and if they do break in, they are often segregated in casual or dead-end low-paying jobs. Their domestic commitments (and culturally induced low self-esteem) seriously restrict their mobility and ability to seize better work opportunities. Women are often excluded from credit programmes because they cannot provide collateral -- in South Asia they lack secure property rights to land, and in Africa formal land titling programmes have sometimes deprived women of their traditional rights to land. Health risks associated with childbearing and with taking care of other family members and the consequent interruptions in employment can make women risky clients for banks, as the experience of women's organisations like SEWA in India has shown. Women's access to extension services is also limited, which is of particular consequence in Africa, where women are heavily involved in production decisions for some crops. And women lack protection from violence in many societies, further limiting their activity and autonomy. All this suggests that the usual public interventions at the household level may be woefully inadequate, calling for more effective gender targeting of policy in expanding their economic and social opportunities.

We have noted in section III that in the case of some disadvantaged groups or backward neighbourhoods or regions there are important externalities which also suggest that anti-poverty policies need to go beyond individuals and households. There is clearly a trade-off here between the increased cost of group-targeting (which will inevitably involve some of the non-poor within a group) and the efficiency gain from internalising the positive externalities. In this connection it is important to analyse the efficiency implications of preferential treatment to disadvantaged minorities in jobs, education, business contracts and permits, etc. Variants of such a policy have been tried in Malaysia, India, the Southern Philippines, and elsewhere. They have often generated a great deal of political controversy, but systematic economic analysis, either theoretical or empirical, of their efficiency effects is scarce, at least compared to the corresponding work on the effects of affirmative action in the United States. Even though some of these policies (like quotas in India in civil service jobs and in admission to higher education for some low-caste or tribal groups) are not directly relevant to the very poor, they can have indirect effects on their chances for upward mobility. (These policies are also easily bypassed in some cases with appropriate deals and bribes: in Malaysia these deals used to be called Ali-Baba combinations, Ali being the Muslim *bumiputera* front man in a business contract and Baba the Chinese businessman).

The standard efficiency argument against job quotas for minorities is that it splinters the labour market, distorts allocation of labour between covered and other sectors, and may adversely affect the incentives for skill acquisition among members of the quota-protected group. But if group-specific dynamic externalities and social capital are important determinants of economic success as in the models of Benabou (1994) and Durlauf (1995),

preferential policies can increase efficiency by changing the way workers are sorted across occupations and firms. In addition, if employers hold negative-stereotype views about minority worker productivity, and if in such cases the return to acquiring signals of ability is low or if signals are uninformative, preferential job policies for some time can help in eliminating stereotypes and thus improving incentives on the part of minority workers for skill acquisition, as Coate and Loury (1993) have pointed out.

To the extent preferential policies are supposed to cope with a historical handicap, their economic rationale is akin to that behind the age-old argument for infant-industry protection in early stages of development. Some disadvantaged groups need temporary protection against competition so that they can participate in learning by doing and on-the-job skill-formation before catching up with the others. Some of the standard arguments against infant-industry protection are then equally applicable against preferential policies. For example, the 'infant', once protected, sometimes refuses to grow up; preferential policies, once adopted, are extremely difficult to reverse. The Indian constitution stipulated a specified duration for job reservation for the lowest castes and tribes; this has not merely been extended indefinitely, the principle of 'reservation' has now been extended to a large number of other castes. Another argument against infant-industry protection is that even when the goal is justifiable, it may be achieved more efficiently through other policies. For example, a disadvantaged group may be helped by a preferential investment policy or development programmes in a particular area where the group is concentrated or with preferential loans, scholarships, job training programmes and extension services for its members, instead of job quotas that bar qualified candidates coming from advanced groups. Such indirect policies of helping out backward groups are also less likely to generate political

resentment (particularly because in this case the burden may be shared more evenly, whereas in the case of job quotas the redistributive burden falls on a small subset of the majority community).

## VI

Finally, we discuss the issue of governance structure in poverty alleviation programmes. There is an increasing awareness that the cause of both efficiency and equity in these programmes will be served better if we move away from state paternalism as well as the harshness of market processes, and instead rely more on local self-governing institutions and community involvement to improve the material conditions and the autonomy of the poor. Even when the state is obligated to spend a significant part of the budget on anti-poverty programmes (as, for example, in India), too often very little reaches the real poor, in the absence of organised pressure from the intended beneficiaries and on account of the programmes being administered by a distant, uncoordinated and corrupt bureaucracy unaccountable and insensitive to the needs of the local poor. Even when it does reach them it often perpetuates a cycle of dependency and an attitude of malfeasance and opportunism among the poor with an eye to milking the state cow for its uncertain bounties. The disproportionate benefits, of course, go to those who have the resources, connections and dexterity to manipulate the milking process and to the large army of middlemen, contractors, officials and politicians.

Devolution of power to the local community usually brings some responsibility in decision-making and in implementation and can provide incentives for improving quality and cost-effectiveness of programmes. Local information can often identify cheaper and more appropriate ways of providing public services. There is also scattered evidence that the serious problem of absenteeism of salaried teachers in village public schools and of doctors in rural public health clinics is significantly reduced when they are made accountable to the local community. Peer monitoring and enforcement of local social sanctions and a common set of norms can provide the basis of social insurance schemes and group borrowing, as we have noted in section IV. In remote regions of poor countries decentralisation also provides a more effective channel of transmitting (and acting upon) early warnings about problems which might develop into disasters (droughts, epidemics, etc.).

In most of the examples above decentralisation with local accountability improves service in publicly supplied facilities. But it may also help in the management of common property resources. The daily livelihood of the poor, particularly in rural areas, depends vitally on the local environmental resources like forestry, grazing, irrigation, fisheries, and so on. The local commons also provide some elementary insurance function for poor peasants, for example as a fallback food and fodder source in bad crop years. There are several documented examples -- see Ostrom(1990) -- in different parts of the world of successful and autonomous local community-level cooperation in management of common property resources. In some cases -- for example, in forest protection and regeneration and wasteland development in India -- there are now some successful instances of joint management by the state and the local community, with the latter taking major responsibilities.

One should, however, resist the temptation to romanticise the value of the local community as a social and economic organisation, as is common among many environmentalists, NGO activists, and other assorted antistate anti-market social thinkers. On the efficiency question the major trade-off is between the need for policy coordination at some central level when there are economies of scale and of scope and interjurisdictional externalities on the one hand, and that for local information and accountability on the other. The importance of the two sides in this trade-off varies from case to case, and it is difficult to pass general judgment on the appropriate extent of decentralisation in the governance structure without looking into the empirical details of each case. On the equity side, it is important to keep in mind that in situations of severe social and economic inequality at the local level, decentralisation can be highly inadequate in helping the poor. It may be easy for the local overlords to capture the local community institutions and the poor may be left grievously exposed to their mercies and their malfeasance. Such capture is more difficult at the national level because the local mafia of different regions may partially neutralise one another. Since there are certain fixed costs of organising resistance groups or lobbies, the poor may sometimes be more unorganised at the local level than at the national level, where they can pool their organising capacities.

In this paper we start by noting that policies that help growth by improving allocational efficiency may also help the poor. We then go on to consider cases where in view of serious agency costs and coordination problems (particularly involving processes in credit and insurance markets) there may be a great deal of scope for trying redistributive projects which at the same time enhance productive efficiency, contrary to the message of efficiency-equity trade-off central to mainstream policy economics. In this

context we discuss the efficiency effects of asset distribution programmes like land reform. We then examine the merits and costs of targeting transfers aimed at improving their cost-effectiveness, including issues of self-selection by the poor and of targeting disadvantaged groups and backward areas. Finally, we discuss governance structures and focus on the role of self-governing institutions at the local level in improving efficiency and equity in poverty alleviation.

## References

- Banerjee, Abhijit and Andrew Newman (1993). 'Occupational Choice and the Process of Development'. *Journal of Political Economy*, vol.101(April), pp.274-98.
- Benabou, Roland (1994). 'Education, Income Distribution, and Growth: The Local Connection'. NBER Working Paper No.4798, Cambridge, MA.
- Bowles, Samuel and Herbert Gintis (1995). 'Efficient Redistribution: New Rules for Markets, States, and Communities', unpublished, Amherst, MA.
- Coate, Stephen and Glenn Loury (1993). 'Will Affirmative Action Policies Eliminate Negative Stereotypes?'. *American Economic Review*, vol.83 (December), pp.1220-40.
- Crane, J. (1991), 'The Epidemic Theory of Ghettos and Neighbourhood Effects on Dropping Out and Teenage Childbearing'. *American Journal of Sociology*, vol.96, pp.1226-59.
- van de Walle, Dominique and Kimberly Nead (eds.) (1995). *Public Spending and the Poor: Theory and Evidence*. Baltimore, MD.: Johns Hopkins University Press.
- Dasgupta, Partha and Debraj Ray (1986). 'Inequality as a Determinant of Malnutrition and Unemployment: Theory'. *Economic Journal*, vol.96 (December), pp.1011-34.
- Durlauf, Steven (1995). 'A Theory of Persistent Income



Inequality'. *Journal of Economic Growth*,  
forthcoming.

Galor, Oded and Joseph Zeira (1993). 'Income Distribution and  
Macroeconomics'. *Review of Economic Studies*,  
vol.60, pp.35-52.

Gelbach, Jonah and Lant Pritchett (1995). 'Does More for the  
Poor Mean Less for the Poor? The Politics of  
Tagging', unpublished, the World Bank.

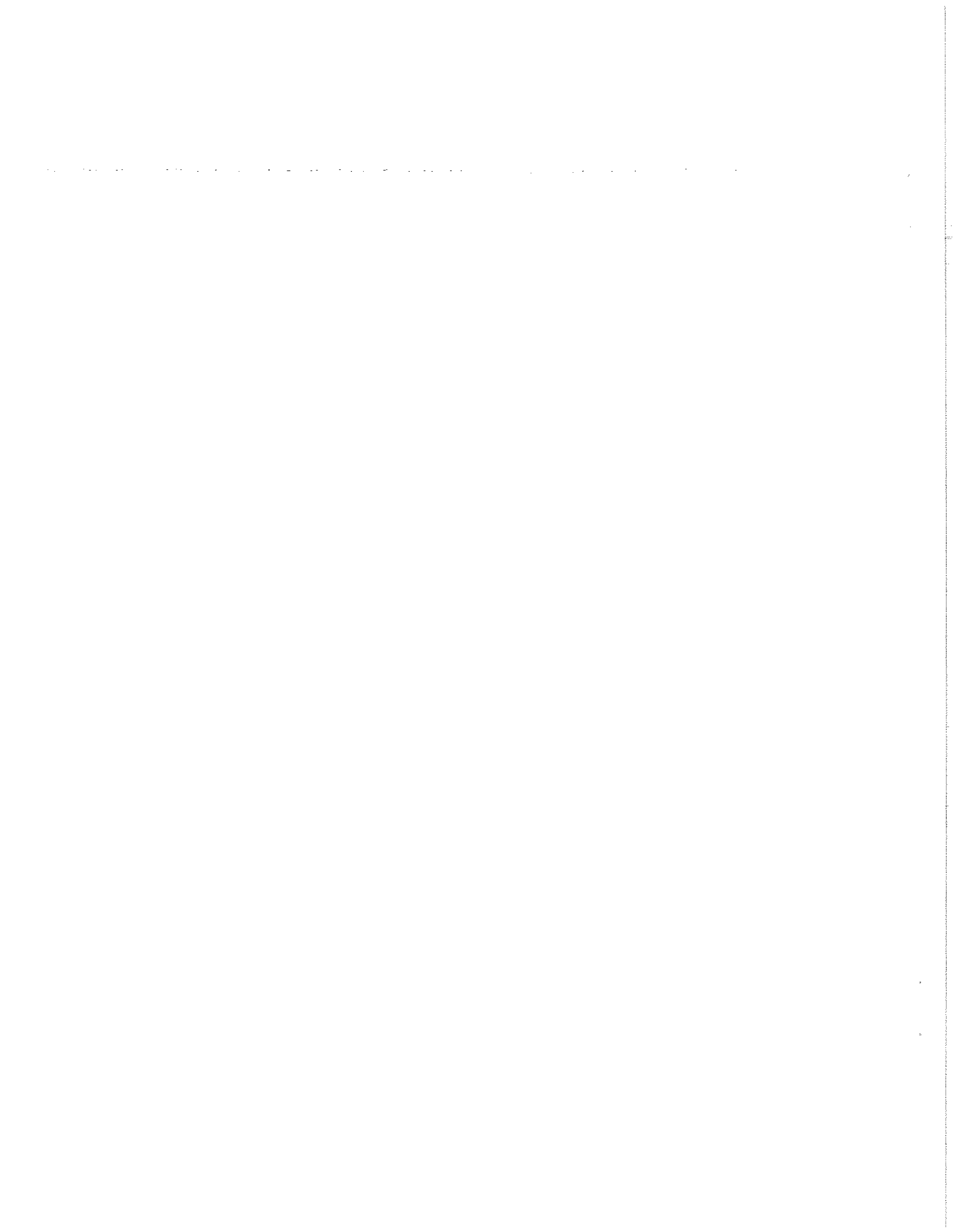
Grossman, Herschel (1992). 'Robin Hood and the Distribution of  
Property Income', IRIS Center Working Paper No.  
43, Maryland.

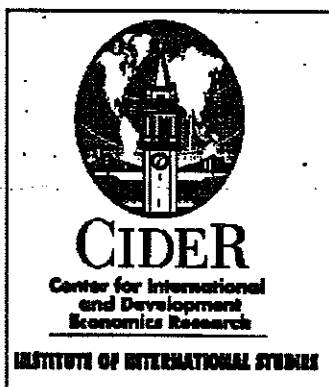
Hayami, Yujiro and Kenjiro Otsuka (1993). *The Economics of  
Contract Choice*. Oxford: Clarendon Press.

Hoff, Karla and Andrew Lyon (1995). 'Non-leaky Buckets:  
Optimal Redistributive Taxation and Agency Costs'.  
*Journal of Public Economics*, vol.58, pp.365-90.

Okun, A.M. (1975). *Equality and Efficiency: The Big Tradeoff*,  
Brookings Institution, Washington, D.C.

Ostrom, Elinor (1990). *Governing the Commons: The Evolution  
of Institutions for Collective Action*, New York:  
Cambridge University Press.





University of California, Berkeley  
Center for International and Development  
Economics Research  
Working Paper Series

The Center for International and Development Economics Research at the University of California, Berkeley is funded by the Ford Foundation. It is a research unit of the Institute of International Studies which works closely with the Department of Economics and the Institute of Business and Economic Research (IBER). Single copies of papers are free. All requests for papers in this series should be directed to IBER, F502 Haas Building, University of California at Berkeley, Berkeley CA 94720-1922; (510) 642-1922; e-mail bagdon@haas.berkeley.edu.

- C96-066 "The Nature of Institutional Impediments to Economic Development." Pranab Bardhan. March 1996.
- C96-065 "Efficiency, Equity and Poverty Alleviation: Policy Issues in Less Developed Countries." Pranab Bardhan. March 1996.
- C96-064 "The Economics of Corruption in Less Developed Countries: A Review of Issues." Pranab Bardhan. February 1996.
- C96-063 "Intertemporal Price Speculation and the Optimal Current-Account Deficit: Reply and Clarification." Maurice Obstfeld. February 1996.
- C96-062 "Currency Crashes in Emerging Markets: Empirical Indicators." Jeffrey J. Frankel and Andrew K. Rose. January 1996.
- C96-061 "The World Over the Next Twenty-five Years: Global Trade Liberalization, and the Relative Growth of Different Regions." Jeffrey Frankel. January 1996.
- C96-060 "Recent Exchange Rate Experience and Proposals for Reform." Jeffrey A. Frankel. January 1996.
- C96-059 "Regional Trading Arrangements: Natural or Super-Natural?" Jeffrey A. Frankel, Ernesto Stein, and Shang-Jin Wei. January 1996.
- C95-058 "How Well Do Foreign Exchange Markets Function: Might a Tobin Tax Help?" Jeffrey Frankel. November 1995.
- C95-057 "What Do Currency Crises Tell Us About the Future of the International Monetary System?" Barry Eichengreen and Charles Wyplosz. October 1995.
- C95-056 "Fiscal Policy and Monetary Union: Federalism, Fiscal Restrictions and the No-Bailout Rule." Barry Eichengreen and Jurgen von Hagen. September 1995.
- C95-055 "A Proposal to Introduce the ECU First in the East." Jeffrey Frankel and Charles Wyplosz. June 1995.
- C95-054 "Liberalized Portfolio Capital Inflows in Emerging Markets: Sterilization, Expectations, and the Incompleteness of Interest Rate Convergence." Jeffrey A. Frankel and Chudozie Okongwu. June 1995.
- C95-053 "European Integration and the Regionalization of World Trade and Currencies: The Economics and the Politics." Jeffrey A. Frankel and Shang-Jin Wei. June 1995.
- C95-052 "A Panel Project on Purchasing Power Parity: Mean Reversion Within and Between Countries." Jeffrey A. Frankel and Andrew K. Rose. June 1995.
- C95-051 "A Survey of Empirical Research on Nominal Exchange Rates." Jeffrey A. Frankel and Andrew K. Rose. June 1995.
- C95-050 "Trade and Growth in East Asian Countries: Cause and Effect?" Jeffrey A. Frankel, David Romer and Teresa Cyrus. June 1995.

- C95-049 "Sterling in Decline Again: The 1931 and 1992 Crises Compared." Barry Eichengreen and Chang-Tai Hsieh. June 1995.
- C95-048 "Exchange Rate Dynamics Redux." Maurice Obstfeld and Kenneth Rogoff. January 1995.
- C95-047 "Is There a Safe Passage to EMU? Evidence on Capital Controls and a Proposal." Barry Eichengreen, Andrew K. Rose, and Charles Wyplosz. January 1995.
- C95-046 "Speculative Attacks on Pegged Exchange Rates: An Empirical Exploration with Special Reference to the European Monetary System." Barry Eichengreen, Andrew K. Rose, and Charles Wyplosz. January 1995.
- C94-045 "Two Cases for Sand in the Wheels of International Finance." Barry Eichengreen, James Tobin, and Charles Wyplosz. December 1994.
- C94-044 "The Intertemporal Approach to the Current Account." Maurice Obstfeld and Kenneth Rogoff. November 1994.
- C94-043 "The Bretton Woods System: Paradise Lost?" Barry Eichengreen. October 1994.
- C94-042 "The Geography of the Gold Standard." Barry Eichengreen and Marc Flandreau. October 1994.
- C94-041 "History and Reform of the International Monetary System." Barry Eichengreen. October 1994.
- C94-040 "The Stability of the Gold Standard and the Evolution of the International Monetary System." Tamim Bayoumi and Barry Eichengreen. October 1994.
- C94-039 "Political Stabilization Cycles in High Inflation Economies." Ernesto Stein and Jorge Streb. August 1994.
- C94-038 "The Contributions of Endogenous Growth Theory to the Analysis of Development Problems: An Assessment." Pranab Bardhan. July 1994.
- C94-037 "International Capital Mobility in the 1990s." Maurice Obstfeld. May 1994.
- C94-036 "Monetary Regime Choices for a Semi-Open Country." Jeffrey A. Frankel. April 1994.
- C94-035 "A Two-Country Analysis of International Targeting of Nominal GNP." Jeffrey A. Frankel and Norbert Funke. April 1994.
- C94-034 "Trading Blocs: The Natural, the Unnatural, and the Super-Natural." Jeffrey Frankel, Ernesto Stein and Shang-jin Wei. April 1994.
- C94-033 "The Internationalization of Equity Markets: Introduction." Jeffrey A. Frankel. April 1994.
- C94-032 "Deja Vu All Over Again: Lessons from the Gold Standard for European Monetary Unification." Barry Eichengreen. January 1994.
- C93-031 "Recent Changes in the Financial Systems of Asian and Pacific Countries." Jeffrey A. Frankel. December 1993.
- C93-030 "One Money or Many? On Analyzing the Prospects for Monetary Unification in Various Parts of the World." Tamim Bayoumi and Barry Eichengreen. November 1993.
- C93-029 "International Economics and Domestic Politics: Notes on the 1920s." Barry Eichengreen and Beth Simmons. November 1993.
- C93-028 "The Reconstruction of the International Economy, 1945-1960." Barry Eichengreen. November 1993.
- C93-027 "The Implications of New Growth Theory for Trade and Development: An Overview." Pranab Bardhan. October 1993.
- C93-026 "Emerging Currency Blocs." Jeffrey A. Frankel and Shang-Jin Wei. October 1993.
- C93-025 "Is There a Currency Bloc in the Pacific?" Jeffrey A. Frankel and Shang-Jin Wei. October 1993.